



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: November 13, 2007

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

UIL: 507.00-00, 4940.00-00, 4941.00-00, 4942.00-00,  
4944.00-00, 4945.00-00

Legend:

A -  
B -  
X -

Dear :

We have considered the request of A and B, dated January 26, 2006, and subsequently amended by a letter dated October 31, 2007 for a ruling concerning the federal income and excise tax consequences of a proposed transfer 25 percent or more of the fair market value of A's net assets to B.

**Facts:**

A and B are recognized as organizations described in section 501(c)(3) of the Internal Revenue Code and are private foundations within the meaning of section 509(a) of the Code. Both A and B are controlled by the same director/trustees. A proposes to transfer its real estate partnership assets to B to further their exempt purposes by facilitating a more efficient distribution of funds, limiting their liability with regard to the assets and simplifying asset management. A and B state that the value of the transfer will be approximately 25 percent or more of the fair market value of A's net assets of \$x and that A will receive no consideration in exchange for the transfer.

Both A and B state that they will make grants to organizations that are exempt under section 501(c)(3) of the Code. The private foundations state that they have not notified the Service that they intend to terminate or received notice that the Service terminated their status as private foundations. They also state that they have no knowledge that either organization has made willful repeated acts (or failures to act) or a willful and flagrant act (or failure to act) that would give rise to a liability for tax under Chapter 42. A and B represent that A's disqualified persons are not affiliated with the transferred assets. Finally, A represents that it will exercise expenditure responsibility with regard to the transferred assets and has drafted sample documents to ensure that B will use the transferred funds properly.

You have requested the following rulings:

1. For purposes of Chapter 42 of the Code (sections 4940 et seq.) and Part II of Subchapter F of Chapter 1 (sections 507 through 509 of the Code), as a result of A's transfer of real estate partnership assets to B, B will be treated as if it were A, and all of the savings provisions applicable to private foundations under the Tax Reform Act of 1969, as amended, will apply to B to the same extent and in the same manner as such provisions applied to A.
2.
  - a. The transfer of real estate partnership assets from A to B will constitute a transfer of assets described in section 507(b)(2) of the Code and sections 1.507-3(a)(1) and (c)(1) of the regulations. Consequently, the transfer will not result in the termination of A's private foundation status or result in an assessment of the termination tax under section 507(c) of the Code against either A or B.
  - b. Under section 507(b)(2) of the Code and section 1.507-3(a)(1) of the regulations, B will not be treated as a newly created organization.
3. A's tax basis and holding period for the assets that B will receive, including the basis computed under section 4940(c)(4)(B) of the Code, will carry over to B in the same manner as if such assets had continued to be held without interruption by A.
4. The transfer of assets:
  - a. Will not itself give rise to net investment income to A under section 4940 of the Code and will not constitute a "sale or other disposition" within the meaning of section 4940(c)(4)(A);
  - b. Will not constitute a direct or indirect act of self-dealing under section 4941 of the Code with regard to A, B, or any foundation managers, substantial contributors or other disqualified persons of A or B;
  - c. Will not constitute an investment by A or B, which jeopardizes the exempt purposes of A or B under section 4944 of the Code;
  - d. Will not constitute a taxable expenditure as defined in section 4945(d) of the Code by A and will not subject A or B to any expenditure responsibility requirements under section 4945(h); and
  - e. To the extent that A has any obligation that requires the exercise of expenditure responsibility under section 4945 of the Code at the time of the transfer, A will continue to exercise expenditure responsibility with respect to such obligations.
4. The distribution requirements of A and B under section 4942 of the Code for the year of the transfer shall be fulfilled by each as determined by the assets held by each.
5. The transfer will not adversely affect the tax-exempt status of A or B, and neither A nor B will be subject to federal income tax under Subtitle A or Chapter 42 of the Code with regard to the transfer.

Law:

Section 501(c)(3) of the Internal Revenue Code exempts organizations that are organized and

operated exclusively for charitable and other exempt purposes from federal income tax.

Section 507(a)(1) of the Code states that the status of any organization as a private foundation is terminated only if it notifies the Secretary of its intent to terminate or there have been either willful repeated acts or a willful and flagrant act giving rise to liability for tax under chapter 42 and the Secretary notifies the organization that it is liable for termination tax under section 507(c).

Section 507(b)(2) of the Code permits one private foundation to transfer its assets to another private foundation without treating the transferee foundation as a newly created organization.

Section 507(c) of the Code imposes a tax on a private foundation that terminates its private foundation status by notifying the Service of its intent to terminate or that has made willful, repeated acts (or failures to act), or a willful and flagrant act (or failure to act) that results in tax under Chapter 42, and the Service has notified the organization that it is liable for the tax and either the organization has paid the tax or the tax was abated.

Section 4940(a) of the Code imposes an annual tax on the net investment income of private foundations.

Section 4940(c) of the Code defines net investment income as the amount by which the sum of the gross investment income and the capital gain net income exceed the allowable deductions and the term "capital gain net income" as gains and losses from the sale or other disposition of property used for the production of interest, dividends, rents, and royalties, and other property used for the production of income included in computing the tax imposed by section 511.

Section 4941(a) of the Code imposes an excise tax on acts of self-dealing between a private foundation and any of its disqualified persons as defined in section 4946.

Section 4942(a) of the Code imposes an annual tax on the undistributed income of a private foundation. It requires a private foundation to pay qualifying distributions, as defined in section 4942(g), to accomplish one or more exempt purposes. A "qualifying distribution" includes any amount paid to accomplish one or more purposes, including reasonable administrative expenses incurred in the direct, active conduct of an exempt purpose, described in section 170(C)(2)(B).

Section 4944(a) of the Code imposes a tax on any investment that jeopardizes an exempt organization's charitable purpose.

Section 4945(a) of the Code imposes a tax on the taxable expenditures of a private foundation.

Section 4945(d)(4) of the Code defines the term "taxable expenditure" as any amount paid or incurred by a private foundation as a grant to an organization unless the organization is described in paragraph (1), (2), or (3) of section 509(a) or is an exempt operating foundation, or the private foundation exercises expenditure responsibility with respect to the grant.

Section 4945(h) of the Code defines the term "expenditure responsibility" to mean that a private foundation is responsible for exerting all reasonable efforts and for establishing procedures to see that the grant is spent solely for the purpose for which made, to obtain full and complete reports from the grantee on how the funds are spent, and to make full and detailed reports with respect to such expenditures to the Secretary.

Section 1.507-3(a)(1) of the Income Tax Regulations states that in the case of a significant disposition of assets to one or more private foundations, within the meaning of paragraph (c) which describes a section 507(b)(2) transfer, the transferee organization shall not be treated as a newly created organization, but shall succeed to those attributes and characteristics of the transferor organization which include its aggregate tax benefit, substantial contributors, and chapter 42 tax and penalty liabilities.

Section 1.507-3(a)(8) of the regulations states that the provisions contained in sections 4940(c)(4)(B), 4942(f)(4), 4941, 4942, 4945, and 508(e), if the conditions described therein are met, shall apply to the transferee foundation with respect to the assets transferred to the same extent and in the same manner that they would have applied to the transferor foundation had the transfer described in section 507(b)(2) not been effected.

Section 1.507-3(c)(1) of the regulations provides that, for purposes of section 507(b)(2), the terms "other adjustment, organization, or reorganization" shall include a significant disposition of assets. The terms "other adjustment, organization, or reorganization" includes any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income.

Section 1.507-3(c)(2) of the regulations provides that the term "significant disposition of assets to one or more private foundations" includes any disposition for a taxable year where the aggregate of the dispositions to one or more private foundations for the taxable year is 25 percent or more of the fair market value of the net assets of the distributing foundation at the beginning of the taxable year.

Section 1.507-3(d) of the regulations states that, unless a private foundation voluntarily gives notice pursuant to section 507(a)(1), a transfer of assets described in section 507(b)(2) will not constitute a termination of the transferor's private foundation status under section 507(a)(1).

Section 1.507-4(b) of the regulations states that private foundations that make transfers described in section 507(b)(2) are not subject to the tax imposed under section 507(c) with respect to such transfers unless the provisions of section 507(a) become applicable.

Section 53.4940-1(f)(1) of the Foundation and Similar Excise Tax Regulations states that a distribution of property for purposes described in section 170(c) of the Code or section 170(c)(2)(B), which is a qualifying distribution under section 4942, shall not be treated as a sale or other distribution of property.

Section 53.4945-5(b)(1) of the regulations provides that a private foundation will be considered to be exercising "expenditure responsibility" under section 4945(h) as long as it exerts all reasonable efforts and establishes adequate procedures: (i) to see that the grant is spent solely



for the purpose for which made, (ii) to obtain full and complete reports from the grantee on how the funds are spent, and (iii) to make full and detailed reports with respect to such expenditures to the Commissioner.

Section 53.4945-5(c)(2) of the regulations states that if a private foundation makes a grant described in section 4945(d)(4) of the Code to a private foundation that is exempt from taxation under section 501(a) for endowment, for the purchase of capital equipment, or for other capital purposes, the grantor foundation shall require annual reports from the grantee on the use of the principal and income (if any) from the grant funds. The grantee shall make such reports annually for its taxable year in which the grant was made and the immediately succeeding two taxable years. Only if it is reasonably apparent to the grantor that, before the end of the second succeeding taxable year, neither the principal, the income from the grant funds, nor the equipment purchased with the grant funds has been used for any purpose which would result in a liability for tax under section 4945(d), the grantor may then allow such reports to be discontinued.

Section 53.4946-1(a)(8) of the regulations states that, for purposes of section 4941 of the Code only, the term "disqualified person" will not include any organization described in section 501(c)(3).

**Analysis:**

This proposed transaction involves a private foundation's transfer of 25 percent or more of the fair market value of its total net assets to an entity that qualifies for exemption under section 501(c)(3) of the Code and that has not notified the Secretary of its intent to terminate its status as a private foundation. Accordingly, the proposed transaction is not a transfer described in section 507(a), which imposes a termination tax under section 507(c). Instead, it is a significant transfer of assets as described in section 507(b)(2). Consequently, B will not be treated as a newly created organization and, with regard to the transferred assets, the provisions described in sections 1.507-3(a)(1) and (8) of the regulations will apply to B to the same extent and in the same manner as they would have applied to A. Because A will make the grant to further their charitable purposes and B is exempt under section 501(c)(3), the transfer will not adversely affect the exempt status of A or B, nor will it be treated as investment income, an act of self-dealing, or a jeopardizing investment within the meaning of sections 4940, 4941, and 4944.

When a private foundation makes a partial transfer of assets to another, under section 507(b)(2) of the Code, the regulations require the exercise of expenditure responsibility. To interpret them otherwise would weaken the section 4945(d)(4) and (h) rules that require expenditure responsibility over grants or "transfers" between private foundations. Accordingly, A's transfer to B will not be considered a taxable expenditure as long as A exercises expenditure responsibility over the grant in accordance with sections 4945(h) and sections 53.4945-5(b)(1) and 53.4945-5(c)(2) of the regulations.

Based on the foregoing, we rule, as requested, as follows:

1. As a result of the transfer, with regard to the transferred assets, B will succeed to A's attributes and characteristics, as described in section 1.507-3(a)(1) of the regulations,

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- and the provisions described in section 1.507-3(a)(8) will apply to B to the same extent and in the same manner as they would have applied to A.
2. The transfer will not result in the termination of A's private foundation status or result in the imposition of a termination tax against either A or B under section 507(c) of the Code and B will not be treated as a newly created organization.
  3. The tax basis and the holding period for the transferred assets will carry over to B.
  4. The transfer:
    - a. Will not give rise to net investment income to A under section 4940 of the Code and will not constitute a "sale or other disposition" within the meaning of section 4940(c)(4)(A).
    - b. Will not constitute a direct or indirect act of self-dealing under section 4941 of the Code with regard to A, B or A's disqualified persons.
    - c. Will not constitute an investment by A or B, which jeopardizes the exempt purposes of A or B under section 4944 of the Code.
    - d. Will not constitute a taxable expenditure as long as A follows the requirements of section 4945(h) of the Code and sections 53.4945-5(b)(1) and 53.4945-5(c)(2) of the regulations.
    - e. Will require A to exercise expenditure responsibility with respect to the transferred assets under section 4945 of the Code.
  5. A and B will each be responsible for meeting their own distribution requirements under section 4942 of the Code.
  6. The transfer will not adversely affect the tax-exempt status of A or B and will not trigger a liability of federal income tax under Subtitle A or excise tax under Chapter 42 of the Code against either A or B.

This ruling is based on the understanding there will be no material changes in the facts upon which it is based. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. This ruling is directed only to the organization that requested it.

Section 6110(k)(3) of the Code provides it may not be used or cited by others as precedent. This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter. In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Elizabeth C. Kastenber

**200806015**

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**Acting Manager, Exempt Organizations  
Technical Group 2**

**Enclosure  
Notice 437**